TUESDAY MORNING FEBRUARY 27, 2007

California Bar Examination

Answer all three questions. Time allotted: three hours

Your answer should demonstrate your ability to analyze the facts in question, to tell the difference between material and immaterial facts, and to discern the points of law and fact upon which the case turns. Your answer should show that you know and understand the pertinent principles and theories of law, their qualifications and limitations, and their relationships to each other.

Your answer should evidence your ability to apply law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal

principles. Instead, try to demonstrate your proficiency in using and applying them.

If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions, and discuss all points thoroughly.

Your answer should be complete, but you should not volunteer information or discuss legal doctrines which are not pertinent to the solution of the problem.

Unless a question expressly asks you to use California law, you should answer according to legal theories and principles of general application.

Builder sold a shopping mall to Owner. The recorded deed from Builder to Owner conveyed the mall and parking lot where the parking spaces were numbered 1 to 100. The deed reserved to Builder the exclusive right to use parking spaces 15 through 20 as a place to set up a stand to sell sports memorabilia and sandwiches on Sundays. The shopping mall was located adjacent to an existing residential neighborhood.

Owner entered into a written 30-year lease with Lois leasing to her a store in the mall and parking spaces 1 through 20. Under the lease, Lois agreed to pay rent monthly and not to assign the lease without Owner's prior written approval. After occupying the leased premises for five years, Lois subleased the store and parking spaces to Fast Food for a term of ten years without first having obtained Owner's written approval.

Fast Food occupied the premises and paid rent to Owner. Fast Food, which operated a take-out restaurant on the premises seven days a week, used state-of-the-art equipment and operated in compliance with all local health ordinances. Notwithstanding this, on warm days when Fast Food was particularly busy, unpleasant cooking odors were emitted from Fast Food's kitchen. The unpleasant odors caused discomfort to many of the homeowners living in the adjacent neighborhood.

On the first Sunday after Fast Food opened its take-out restaurant, Builder set up his memorabilia and sandwich stand in parking spaces 15 through 20. Fast Food, not aware of the provision in the deed, complained to Builder about the competition of Builder's sandwich sales and the occupancy of parking spaces allocated to Fast Food. Builder ignored Fast Food's complaints. Fast Food then informed Owner that it would cease paying rent until Owner took steps to prevent Builder from using the parking spaces. Owner explained to Fast Food that there was nothing he could do about it, but Fast Food insisted that it would not pay further rent until Owner stopped Builder from setting up his stand. Thereupon, Owner hired a locksmith, who changed the locks on the space occupied by Fast Food, thus denying Fast Food access to the premises.

- 1. Did Lois violate the "no-assignment" provision in her lease with Owner? Discuss.
- 2. If Fast Food brings an action in trespass against Builder for his use of parking spaces 15 through 20, is Fast Food likely to prevail? Discuss.
- 3. Did Owner have the right to change the locks on Fast Food's premises? Discuss.
- 4. Can the homeowners establish a claim for nuisance against Fast Food? Discuss.

Rita and Fred wanted to form a corporation to be named "Rita's Kitchen, Inc." (RKI) for the purpose of opening a restaurant. They contacted 75 friends who agreed individually to become investors in RKI. Five of these investors also agreed to serve on the RKI Board of Directors with Rita and Fred.

Rita and Fred entered into a five-year lease with Landlord for restaurant space, naming "Rita's Kitchen, Inc., a corporation in formation" as the tenant. They signed the lease as "President" and "Secretary," respectively.

Rita and Fred retained Art as their attorney to form the corporation. They told Art that 75 of their friends had committed to invest and become shareholders of RKI. Irv was a duly appointed representative of the 75 investors. Rita, Fred and Irv met with Art, and they agreed that Art would represent Rita, Fred, and all the investors. After extensive discussions with Rita, Fred, and Irv about the operation of the proposed business, Art agreed to prepare the necessary documentation to incorporate RKI.

Later, outside of Irv's presence, Rita and Fred asked Art to draft a shareholder agreement that would specifically designate Rita and Fred as permanent directors and officers of RKI and set Rita and Fred's annual salaries at 12.5% of the corporate earnings. Without further discussion, Art properly formed the corporation. He then prepared the shareholder agreement, including the terms that Rita and Fred had requested.

The 75 investors each purchased their shares of stock and signed the shareholder agreement. RKI operated for one year but failed to make a profit. RKI ceased operations and currently owes three months of back rent under the lease.

- Can Landlord recover the unpaid rent from Rita and Fred individually? Discuss.
- 2. Is the shareholder agreement valid? Discuss.
- 3. What ethical violations, if any, has Art committed? Discuss, including distinctions, if any, between the ABA Model Rules and California authorities.

Do not discuss federal and state securities laws.

Dan has been in and out of mental institutions most of his life. While working in a grocery store stocking shelves, he got into an argument with Vic, a customer who complained that Dan was blocking the aisle. When Dan swore at Vic and threatened to kick him out of the store, Vic told Dan that he was crazy and should be locked up. Dan exploded in anger, shouted he would kill Vic, and struck Vic with his fist, knocking Vic down. As Vic fell, he hit his head on the tile floor, suffered a skull fracture, and died.

Dan was charged with murder. He pleaded not guilty and not guilty by reason of insanity. At the ensuing jury trial, Dan took the stand and testified that he had been provoked to violence by Vic's crude remarks and could not stop himself from striking Vic. Several witnesses, including a psychiatrist, testified about Dan's history of mental illness and his continued erratic behavior despite treatment.

- 1. Can the jury properly find Dan guilty of first degree murder? Discuss.
- 2. Can the jury properly find Dan guilty of second degree murder? Discuss.
- 3. Can the jury properly find Dan guilty of voluntary manslaughter? Discuss.
- 4. Can the jury properly find Dan not guilty by reason of insanity? Discuss.

THURSDAY MORNING MARCH 1, 2007

California Bar Examination

Answer all three questions. Time allotted: three hours

Your answer should demonstrate your ability to analyze the facts in question, to tell the difference between material and immaterial facts, and to discern the points of law and fact upon which the case turns. Your answer should show that you know and understand the pertinent principles and theories of law, their qualifications and limitations, and their relationships to each other.

Your answer should evidence your ability to apply law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal

principles. Instead, try to demonstrate your proficiency in using and applying them.

If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions, and discuss all points thoroughly.

Your answer should be complete, but you should not volunteer information or discuss legal doctrines which are not pertinent to the solution of the problem.

Unless a question expressly asks you to use California law, you should answer according to legal theories and principles of general application.

In 2001 Tom, a resident of California, executed a valid typewritten and witnessed will. At that time, Tom was married to Wynn. Tom also had two nephews, Norm, and Matt, who were the children of his deceased sister, Sue.

Tom's will made the following dispositions:

Article 1: I leave \$10,000 to my friend Frank.

Article 2: I leave my shares in Beta Corp stock to my friend Frank.

Article 3: I leave \$80,000 to my sister Sue's issue.

Article 4: I leave the residue of my estate to my wife.

The \$10,000 figure in Article 1 was crossed out and \$12,000 was handwritten in Tom's hand above the \$10,000 figure. Next to the \$12,000 Tom had handwritten, "Okay. 2/15/02."

In 2003 Tom and Wynn had a child, Cole.

In 2004, Matt died in a car accident. Matt was survived by his children, Lynn and Kim.

Tom died in 2005. Tom was survived by Wynn, Cole, Norm, Frank, and his grandnieces, Lynn and Kim. At the time of his death, Tom owned, as separate property, \$500,000 in cash. He also had 100 shares of Beta Corp stock, titled in Tom's name, which he had purchased with his earnings while married to Wynn. The Beta stock was valued at \$1.00 per share at the time of Tom's death.

What rights, if any, do Wynn, Cole, Norm, Frank, and his grandnieces Lynn and Kim have in Tom's estate? Discuss.

Answer according to California law.

City has adopted an ordinance banning tobacco advertising on billboards, store windows, any site within 1,000 feet of a school, and "any other location where minors under the age of 18 years traditionally gather."

The purpose of the ordinance is to discourage school-age children from smoking. The likely result of the ordinance will be to cause the removal of tobacco advertising from the vicinity of schools, day care centers, playgrounds, and amusement arcades.

The Association of Retailers (AOR) was formed to protect the economic interests of its member retailers. AOR had unsuccessfully opposed the adoption of the ordinance, arguing that it would cause hardship to store owners by depriving them of needed advertising revenue. AOR believes that the best way to discourage young people from smoking is by directly restricting access to tobacco rather than by banning all tobacco advertising.

AOR is considering filing a complaint for injunctive relief against City in federal district court claiming that the ordinance deprives its members of rights under the Free Speech Clause of the First Amendment.

What arguments could AOR reasonably make to show that it has standing, and that its First Amendment free speech claim has merit, and would it be likely to succeed? Discuss.

Officer Will, a police officer, stopped Calvin, who was driving a rental car at five miles an hour over the speed limit. Calvin gave legally valid consent to search the car. Officer Will discovered a substantial quantity of cocaine in the console between the two front seats and arrested Calvin. After being given and waiving his Miranda rights, Calvin explained that he was driving the car for his friend, Donna. He said that Donna was going to meet him at a particular destination to collect her cocaine, which belonged to her. Hoping to obtain a favorable plea bargain, Calvin offered to cooperate with the police. The police then arranged for Calvin to deliver the cocaine. When Donna met Calvin at the destination, she got into the car with Calvin. She was then arrested. Each was charged with and tried separately for distribution of cocaine and conspiracy to distribute cocaine.

Donna's trial began while Calvin's case was still pending.

At Donna's trial, the following occurred:

- (1) The prosecutor called Officer Will, who testified to Calvin's statements after his arrest concerning Donna's role in the transaction.
- (2) The prosecutor then called Ned, an experienced detective assigned to the Narcotics Bureau, who testified that high level drug dealers customarily use others to transport their drugs for them.

In the defense case, Donna testified that she was not a drug dealer and that she knew nothing about the cocaine. She stated that she was merely meeting Calvin because he was an old friend who had called to say he was coming to town and would like to see her.

- (3) Donna further testified that when she was in the car with Calvin, she found a receipt for the rental car, which showed that Calvin had rented it six months prior to his arrest. She offered a copy of the receipt into evidence. The court admitted the document in evidence.
- **(4)** On cross-examination, the prosecutor asked Donna whether she had lied on her income tax returns.

The prosecutor had no evidence that Donna had lied on her income tax returns, but believed that it was likely on the basis that drug dealers do not generally report their income. Donna denied lying on her income tax returns.

Assuming that, in each instance, all the appropriate objections were made, should the evidence in numbers 1, 2, and 3 have been admitted, and should the cross-examination in 4 have been allowed? Discuss.

TUESDAY AFTERNOON FEBRUARY 27, 2007

California
Bar
Examination

Performance Test A
INSTRUCTIONS AND FILE

PHENOM NETWORKS v. JASMINE SEMICONDUCTOR

Instructions	İ
FILE	
Memorandum from Susan Reed to Applicant	1
Memorandum Regarding Persuasive Briefs and Memoranda	2
Transcript of Interview of Valerie Wong	4
Transcript of Voicemail from Banerjee and Gross	9
Plaintiff's Memorandum of Points and Authorities in Support of Motion for Preliminary Injunction to Prohibit Use and Disclosure of Recorded Attorney-Client Communication	1

PHENOM NETWORKS v. JASMINE SEMICONDUCTOR

INSTRUCTIONS

- You will have three hours to complete this session of the examination.
 This performance test is designed to evaluate your ability to handle a select number of legal authorities in the context of a factual problem involving a client.
- 2. The problem is set in the fictional State of Columbia, one of the United States.
- 3. You will have two sets of materials with which to work: a File and a Library.
- 4. The File contains factual materials about your case. The first document is a memorandum containing the instructions for the tasks you are to complete.
- 5. The Library contains the legal authorities needed to complete the tasks. The case reports may be real, modified, or written solely for the purpose of this performance test. If the cases appear familiar to you, do not assume that they are precisely the same as you have read before. Read each thoroughly, as if it were new to you. You should assume that cases were decided in the jurisdictions and on the dates shown. In citing cases from the Library, you may use abbreviations and omit page citations.
- 6. You should concentrate on the materials provided, but you should also bring to bear on the problem your general knowledge of the law. What you have learned in law school and elsewhere provides the general background for analyzing the problem; the File and Library provide the specific materials with which you must work.
- 7. Although there are no restrictions on how you apportion your time, you should probably allocate at least 90 minutes to reading and organizing before you begin preparing your response.
- 8. Your response will be graded on its compliance with instructions and on its content, thoroughness, and organization.

Reed, Newcomb and Lev

Attorneys and Counselors at Law Menlo Parque, Columbia "First In Technology"

MEMORANDUM

To: Applicant

From: Susan Reed

Date: February 27, 2007

Re: Phenom Networks v. Jasmine Semiconductor

We have finished drafting our client Jasmine Semiconductor's ("Jasmine") complaint against Phenom Networks ("Phenom") for fraud and theft of trade secrets. I have just been called by Phenom's litigation counsel to inform me they have made a motion to prohibit disclosure to anyone, including the court, of a recorded voicemail conversation we have of Phenom's Executive Vice President and its attorney discussing their attempt to steal Jasmine's technology and personnel. The voicemail was left in a call to Valerie Wong, Jasmine's in-house legal counsel.

Please prepare our memorandum of points and authorities in opposition to the motion for a preliminary injunction, following our attached guidelines. Your memorandum should present our best arguments, and at the same time, address each of the arguments made in Phenom's brief to preclude our use of the voicemail as evidence. There are obvious issues of professional responsibility involved in this whole mess. Do not concern yourself with any such issues. Another associate is dealing with those issues. I will take care of preparing Ms. Wong's declaration authenticating the transcript of the voicemail. The transcript will be attached to her declaration, and you may use the contents of the voicemail in your memorandum.

Reed, Newcomb and Lev

Attorneys and Counselors at Law Menlo Parque, Columbia "First In Technology"

MEMORANDUM

To: Attorneys

From: Executive Committee

Re: Persuasive Briefs and Memoranda

To clarify the expectations of the firm and to provide guidance to attorneys, all persuasive briefs including briefs in support of or in opposition to motions (also called memoranda of points and authorities), whether directed to an appellate court, trial court, arbitration panel, or administrative officer shall conform to the following guidelines.

All of these documents shall include a Statement of Facts. Select carefully the facts that are pertinent to the legal arguments. The facts must be stated briefly, cogently, and accurately, although emphasis is not improper. The aim of the Statement of Facts is to persuade the tribunal that the facts support our client's position.

Following the Statement of Facts, the Argument should begin. The firm follows the practice of writing carefully crafted subject headings that illustrate the arguments they cover. The argument heading should succinctly summarize the reasons the tribunal should take the position you are advocating. A heading should be a specific application of a rule of law to the facts of the case and not a bare legal or factual conclusion or statement of an abstract principle. For example, IMPROPER: COLUMBIA HAS PERSONAL JURISDICTION. PROPER: DEFENDANT'S RADIO BROADCASTS INTO COLUMBIA CONSTITUTE MINIMUM CONTACTS SUFFICIENT TO ESTABLISH PERSONAL JURISDICTION.

The body of each argument should analyze applicable legal authority and persuasively argue how the facts and law support our client's position. Authority supportive of our client's position should be emphasized, but contrary authority should generally be cited, addressed in the argument, and explained or distinguished. Do not reserve arguments for reply or supplemental briefs.

Associates should not prepare a table of contents, a table of cases, a summary of the case or the index. These will be prepared, where required, after the draft is approved.

TRANSCRIPT OF INTERVIEW OF VALERIE WONG

- 2 **To:** Jasmine and Phenom Pre-Litigation File
- 3 **Date:** February 20, 2007
- 4 Re: Interview of Valerie Wong, Jasmine Senior Director of Legal and Business
- 5 Affairs

1

- Susan Reed ("Reed"): Thanks for coming right over, Valerie. You covered a good bit of
- the background when you called, and I talked to my patent partner to learn about Jasmine,
- 8 its dealings with Phenom, and the nondisclosure agreement that you had with Phenom.
- 9 Valerie Wong ("Wong"): Yes, after two years of development, we were ready to
- commercialize the technology we call TocTec into a product for market. Phenom, which
- had been working in the same technology, and guessed we were way ahead of them,
- wanted to buy it, and take over the key developers. So, we began a process of showing
- them just enough so that we could get full partnership, producing the product, not just a
- buyout. We wanted a full share in development and to keep control of our product.
- 15 Phenom kept putting off negotiations on the eventual deal and instead wanted even more
- product info. We resisted, finally saying no to most of their requests. We never got very
- far with negotiations on the joint development contract that we wanted, but Phenom did
- accept and sign the nondisclosure agreement. So, on that basis we did go ahead with
- restricted, tightly controlled sharing of information. That disclosure is what's been going on
- the last few weeks. Then I got this call from them last night.
- 21 **Reed**: Let's get right to the voicemail.
- Wong: I've never seen, I should say, never heard anything like it. I've got my answering
- 23 machine. Do you want to hear it, or read the transcript?
- Reed: Both. I'll read it while you set up. And of course I'll keep a copy of the written
- transcript.

Wong: And I've made a couple of annotations on it. Since I know both of them on the tape and know all of the others mentioned, I identified each speaker and added a note on who the others are.

Reed: OK, Valerie, I've read it. All set. I may need to hear it to believe it too.

5 ****

6 [Listening to voicemail]

7 ****

Reed: Valerie, it's still difficult to believe what they're saying, even after hearing it.

9 What was your reaction?

Wong: I did not understand it. Imagine it. I listen to a message, just saying that Gross and Banerjee had called. Then about 5 seconds of silence -- and I was reaching to erase it then -- when all of a sudden, they're still talking. I thought that they were talking to me, at first that it was Gross again complaining that I'm going too slow, being too careful. Gross was always telling me that, and trying to get me to accept their boilerplate nondisclosure language or open up more technology before our restricted nondisclosure agreement was signed. We had refused, and, as I said, they signed our nondisclosure agreement before there had been any disclosure.

Reed: Yes. But

Wong: The first time I listened to the entire message in total confusion . . . thinking, what is this? Why are they telling this to me? It really had not sunk in. I had just come from a meeting with Barney, so I knew he was there, and I ran and dragged him to my office.

Reed: Barney is . . . ?

Wong: Barney Ng, our CEO. Halfway through the voicemail he burst out, "The sleazebags don't know they're still on your voicemail!" I actually think that's the moment

- I finally accepted what it was. Until then, I guess I resisted, thinking this may be a joke,
- a dream. Everything just took off, exploded, it seemed.
- Reed: How? I mean, how else?
- Wong: Barney takes off the second we hear the dial tone, the end. Runs to Kathleen's
- office, oh, Kathleen Schaus, the one they talk about in the voicemail, she's manager of
- 6 our TocTec project.
- 7 **Reed:** My patent partner told me about Kathleen. He had worked with her in the patent
- 8 application for TocTec. What did Barney do?
- 9 **Wong:** Kathleen wasn't there, but Barney looked at her files, messages. It was even
- worse than we'd heard on the voicemail. Kathleen had sent Banerjee almost the entire
- patent disclosure file -- our most important intellectual property, and the very technology
- that we had refused to let them copy and many more details than we ever showed
- them. I'd spent weeks negotiating a nondisclosure agreement allowing the Phenom
- engineers a very limited look-see at what our technology could do. We denied them
- any access to the patent application. There had been many conditions to prevent them
- from stealing our technology or people.
- 17 **Reed:** Such as?
- Wong: Whatever they viewed could not be copied or removed. We blacked out the
- names of our employees working on TocTec. We did let them see some confidential
- trade secrets under the nondisclosure agreement. Mostly they only saw the technology
- in operation, what it could do, and we tried to withhold as much as we could of how it
- worked. Keeping that technology and time-to-market advantage is what we were
- protecting in the nondisclosure agreement.
- 24 **Reed:** You mentioned the engineers?
- Wong: Yes. The nondisclosure agreement prohibited them from contacting our key
- engineers, and all meetings with our personnel had to be in the presence of our human
- 27 relations director. We denied them important personnel information, such as pay, stock

- options, benefits, that could then be used to entice them away from us with their
- 2 knowledge of our technology, if we did not conclude a joint development contract.
- 3 Kathleen gave it to them, all of it.
- 4 **Reed:** Valerie, what do you think Gross and Banerjee are talking about where they say
- 5 it would be ok if the deal closes?
- Wong: I guess that if they paid for our technology, there would be no problem, even
- though it doesn't sound like that was what they were going to do. Instead they planned
- 8 to steal our technology and recruit the right engineers, and then they could beat us in
- 9 the marketplace . . . they have their economic might, since they are a much bigger
- company than we are, as just a start-up, plus they then have the new revenue stream of
- a fabulously successful product. No one else in the industry will touch our technology;
- it's tainted, too late, and at best a guaranteed fight with Phenom. We have a lawsuit,
- but no product to the market; they drag it out, and eventually we'd have to accept a
- bitter settlement, or just walk.
- 15 **Reed:** The big boys in Tech Valley play real hardball.
- Wong: They were just trying to mislead us long enough to clean us out, and then dare
- us to fight.
- 18 **Reed:** With this, we may change the usual scenario. Let me see if I've got anything
- more. There's little doubt from what's said that Gross and Banerjee know that what
- they are doing is fraudulent. Gross is even counseling Banerjee, preparing for the
- cover-up.
- Wong: And the mention of blackmail and leverage, is, I guess, their worry that if we
- catch them, then we'll . . . threaten to smear them, and use it to up our contractual
- demands. They assume that we'd act like them.
- Reed: Meantime, Kathleen's gone, right?
- Wong: Yes. Her office is locked up. Security has never allowed her back in. We are
- taking stock of her damage, tracing everything she sent over to Phenom. I'll have a

- report for you and Barney by tomorrow. But I expect that Kathleen's already set up a new office over at the Phenom's campus.
- Reed: We both have a lot to do. We will crank up and prepare to file a complaint and
- 4 enjoin any use of everything they took illegally.

5 **END OF INTERVIEW**

TRANSCRIPT OF VOICEMAIL FROM KAI BANERJEE AND MATTHEW GROSS

- Kai Banerjee ("Banerjee"): Valerie, hi. This is Kai Banerjee [Executive VP for Phenom]. It's a few minutes before six on Thursday, August 16th. I am here with Matthew Gross [Phenom's General Counsel]. We'd like to discuss where we go from here. Please give me a call as soon as possible.
- 6 [about 5 seconds of silence]
- Matthew Gross ("Gross"): Too bad. Not there. . . . But as you said, Kai, we can use a little more time.
- Banerjee: That's ok. . . Matt, you lawyers just keep this unsettled with whatever legal maneuvers you need, so we, you know, can get enough of their TocTec technology and we can get the right people in their engineering unit to quit and come with us.
- Gross: Valerie's so cautious, so paranoid, that, that's not hard. If she or Ng were suspicious, she'll draft another nondisclosure agreement.
- Banerjee: We took their technology on the pretense of just evaluating it, not putting it in our product But they gave it to us, you know. . . . But if it looks like we are going to get closure, and close the deal, right?
- Gross: Sure, if we were to close the deal, everything's probably fine, but if they realize what we're doing, they could hold out for more. Use it as leverage, use it as blackmail.
- Banerjee: That's right. So that's how I, as our project leader, can defend it, and that's how we can defend it. They gave it to us to use. If we end up having to pay Jasmine, it's no harm, no foul.
- 22 **Gross:** That's, that's what's going on right now. If it blows up, maybe Manuel Lopez [Phenom's Vice President for business development] gets a black eye.
- 24 **Banerjee:** How's that?

1

- Gross: Sure, Manuel is our VP out there promising big option grants if their technology is transferred in advance to speed development time so time-to-market goal can be reached. That's what's going on.
- Banerjee: Matt, something else. I'm getting scared, Kathleen Shaus, Jasmine's TocTec Project manager, is transferring too much. Not just the engineers' salaries and stock options, but all the product designers' personnel files, people we don't need to bring over. And this morning she sent over pretty much all of Jasmine's TocTec patent disclosures.
- 9 **Gross:** All at once?
- Banerjee: Yeah. One super-stuffed e-mail attachment. Lopez says he'll need at least a week to get through it.
- Gross: I know we asked for most of the stuff, but it's coming too fast and that can give her away.
- Banerjee: That's right. What do you think, Matt, should I do something?
- Gross: Yeah, call her. No, better, e-mail her, so we leave a paper trail. Make it sound polite, like, appreciate your generous courtesy, and her cooperation exceeds Jasmine's commitments, like it's all her idea. Thank her for assisting us to do our technical due diligence and that if we do it faster, it will benefit both companies no say benefit both of us. She'll understand that. Do it now, so I can review it while I'm here.
- 20 **Banerjee:** OK, right now.

21 END OF VOICEMAIL RECORDING

1	Lisa Fong, ESQ.
2	MADISON AND SUTRO
3	67 Oakmont Avenue, 6 th Floor
4	Soper, Columbia
5	(555)652-7389
6	Attorneys for Plaintiff
7	
8	SUPERIOR COURT OF COLUMBIA
9	IN AND FOR THE COUNTY OF PALA
10	
11	
12	PHENOM NETWORKS,
13	Plaintiff,
14	Case No. 6586359
15	vs.
16	
17	JASMINE SEMICONDUCTOR,
18	Defendant
19	/
20	
21	
22	PLAINTIFF'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF
23	MOTION FOR PRELIMINARY INJUNCTION TO PROHIBIT USE AND DISCLOSURE
24	OF RECORDED ATTORNEY-CLIENT COMMUNICATION
25	
26	I. Introduction
27	This application rests on a few, indisputable facts; it seeks emergency, preliminary relief
28	based on inarguable, well-settled Columbia law.

Confidential communications between Plaintiff's senior corporate officer and its general counsel were surreptitiously captured and copied by the Defendant, a competitor of the Plaintiff in the aggressive high-tech industry.

The communications were plainly privileged. And counsel for Defendant could have determined in seconds that the conversation was confidential and that Plaintiff's officer and attorney were unaware that they were being electronically eavesdropped.

A brief listening to a recording of the attorney-client conversation or look at a transcript, and a simple phone call could have resolved the matter. Instead, we believe that Jasmine and its counsel have copied, transcribed, and analyzed the contents of the confidential communications.

This Court should not countenance, or indeed encourage, conduct that is so plainly in derogation of the strong policy in favor of confidentiality.

II. Statement of Facts

Plaintiff Phenom Networks (Phenom) is a publicly held company producing telecommunications equipment in Columbia. Defendant Jasmine Semiconductor (Jasmine) is a closely held private company which designs and manufactures telecommunications chips.

Phenom and Jasmine have been working separately on the development of TocTec. Jasmine offered to sell to Phenom Jasmine's relevant technology. To further induce Phenom to accept the offer, Jasmine allowed Phenom to review its technology and interview its engineering staff, without prior commitment or payment. Ultimately Phenom determined that its own technology was better and more advanced than Jasmine's, and that a superior product could be marketed sooner without Jasmine's participation.

It cannot be overemphasized that these kinds of offers, exchange of technology for review, and interchanges of technical staffs are common in the technology-based and fast developing telecommunications industry. And most end as did Phenom's 1 consideration of the Jasmine offer: Phenom declined Jasmine's offer to sell. We 2 thought that the negotiations were done.

Then, two days ago, a former Jasmine engineer applied for an engineering position with Phenom and during her interview disclosed that Jasmine had surreptitiously recorded a voicemail conversation (the "Voicemail") between Phenom's Executive Vice-President Kai Banerjee¹ and its General Counsel Matthew Gross.²

The verbatim contents of the Voicemail are unknown to Phenom. We have neither heard the recorded Voicemail nor seen a transcript of the conversation. However, conversations between Messrs. Banerjee and Gross during the period of the negotiations with Jasmine concerned Phenom's rights and obligations in what could have been a very complicated, costly technology transfer agreement. Their conversations during this time almost certainly included Phenom's confidential assessment of Jasmine's technology, and Banerjee would have made confidential disclosures to his attorney Gross on the status of Phenom's own technical developments, its shortcomings and problems, and its timetable for getting a product to market.

During this period, Banerjee and Gross were constantly discussing whether to pursue the Jasmine offer. It would be expected that Banerjee would be disclosing confidential information comparing Jasmine's to Phenom's technology, and requesting and receiving confidential legal advice from Gross. There could not be a clearer case of confidential attorney-client communications.

22 //

23 //

¹ Mr. Banerjee is a senior Phenom executive, second only to its Chairman and Chief Operating Officer Suhan Bizhar. Banerjee is Executive Vice-President, and Vice-Chairman of the Board of Directors.

² Mr. Gross is a member of the San Carlito law firm of Nemer-Fields.

III. Argument

A. This Court Should Not Permit the Inadvertent Capture of Communications That On Their Face Appear to be Subject to the Attorney-Client Privilege, And It Is Clear They Were Confidential.

The concept of confidentiality is a fundamental aspect of the right to the effective assistance of counsel. The confidentiality principle rests on the vital importance society places upon the "full, free and frank" exchange between lawyer and client, shielded from the intrusive eyes and ears of adverse parties, the government, the media and the public.

This was recently reiterated by the leading Columbia case of *State Fund v. WPS, Inc.*, 1999, where the Court of Appeal stated:

The conclusion we reach is fundamentally based on the importance which the attorney-client privilege holds in the jurisprudence of this state. Without it, full disclosure by clients to their counsel would not occur, with the result that the ends of justice would not be properly served. We believe a client should not enter the attorney-client relationship fearful that an inadvertent error by its counsel could result in the waiver of privileged information.

The Court in *State Fund* acknowledged that its conclusion was grounded in the concern of "preserving confidentiality given the burgeoning of multi-party cases, the availability of xerography and the proliferation of facsimile machines and electronic mail *that make it technologically ever more likely that through inadvertence, privileged or confidential materials will be produced to opposing counsel by no more than the pushing of the wrong speed dial number on a facsimile machine.*" (Emphasis added.)

We are taught from first-year law school that waiver means the intentional relinquishment or abandonment of a known right. Inadvertent production is the antithesis of that concept. Phenom's lawyer might well have been negligent in failing to hit the disconnect button to terminate a conference call. But if we are serious about the attorney-client privilege and its relation to the client's welfare, we should require more

than a trivial mistake by counsel before the client can be deemed to have given up the privilege.

B. The Court May Not Require Disclosure of the Voicemail Claimed to be Privileged, And Its Contents Must Be Sealed For Purposes of this Motion.

Columbia Evidence Code Section 915 provides in part that "[t]he presiding officer may not require disclosure of information claimed to be privileged under section 954 (lawyer-client privilege) in order to rule on the claim of privilege." (Emphasis added.) This is the common situation on privilege determinations.

This Court can determine whether there is a prima facie case that the communication recorded between an attorney and his client is privileged without reviewing the contents of the Voicemail. Next, the Court can determine, again without resort to the privileged communication, that the attorney-client privilege has not been waived by the inadvertent disclosure by counsel.

A party need not give up the right to keep communications confidential in order to obtain judicial protection of attorney-client confidences. Listening to the Voicemail is not necessary to determine that Plaintiff has met all the elements of the test established in *State Fund v. WPS, Inc.*, Columbia Court of Appeal, 1999, where the court stated:

When a lawyer who receives materials that *obviously appear to be subject to an attorney-client privilege* or otherwise clearly appear to be confidential and privileged and *where it is reasonably apparent that the materials were provided or made available through inadvertence* . . . [t]he parties may then proceed to resolve the situation by agreement or may resort to the court for guidance with the benefit of protective orders and other judicial intervention as may be justified. (Emphasis added.)

Indeed, the court in *State Fund* did not resort to the contents of the documents claimed to be privileged. Instead the court relied on testimony by counsel about the contents

and purpose of documents to decide that it clearly appeared that the documents contained confidential communications.

C. Defendant Cannot Rebut the Presumption or Phenom's Affirmative Evidence that the Electronically Eavesdropped Conversation Between a Senior Officer of Phenom and its Counsel Were Privileged Attorney-Client Communications.

Columbia Evidence Code Section 917 provides that "[w]henever a privilege is claimed on the ground that the matter sought to be disclosed is a communication made in confidence in the course of the lawyer-client relationship, the communication is presumed to have been made in confidence and the opponent of the claim of privilege has the burden of proof to establish that the communication was not confidential."

Additionally Columbia Evidence Code Section 952 provides that "in confidence" means a communication that "so far as the client is aware, discloses the information to no third persons other than those who are present." The section's comments make clear that so long as the client, in this case the authorized representative of Phenom, Mr. Banerjee, believed that his conversation with his lawyer was not being overheard, then their communications were "in confidence."

At the time that the Voicemail was recorded, Mr. Matthew Gross was the General Counsel of Phenom, and Mr. Banerjee was a senior Phenom executive, second only to its Chairman and Chief Operating Officer Suhan Bizhar. Mr. Banerjee, as Executive Vice-President, and Vice-Chairman of the Board of Directors, is "a person who is authorized to claim the privilege by the holder of the privilege" pursuant to Columbia Evidence Code Section 954. Their conversations must be presumed to be attorney-client communications.

Additionally, the Plaintiff has affirmatively shown that the conversations between Messrs. Banerjee and Gross during the period of the negotiations with Jasmine included, for example, Phenom's rights and obligations in the negotiations, Phenom's

confidential assessment of Jasmine's technology, and requested confidential legal advice from Gross.

Phenom has met the burden of establishing the foundation facts that its communication was "in confidence in the course of the lawyer-client relationship" requiring application of the attorney-client privilege. (Evid. Code § 917.) The presumption and proof of confidentiality will not and cannot be rebutted. There could not be a clearer case of confidential attorney-client communications.

D. Phenom Has Aggressively Defended its Privileged Communications, And a Waiver Cannot be Inferred From the Inadvertent Disclosure By Its Counsel.

Columbia Evidence Code Section 912 states the general rule that the attorney-client privilege can be waived only if the privilege holder discloses the communication or consents to the disclosure by another. "The language of the statute [Evidence Code Section 912] indicates that we are to look to the words and conduct of the holder of the privilege to determine whether a waiver has occurred." (*State Fund v. WPS*, *supra.*)

Jasmine will be hard-pressed to present any evidence of disclosure of the communication by Phenom. The only evidence is that presented by Phenom from Banerjee and Gross that the only time during the period of negotiations that both Messrs. Banerjee and Gross were on a telephone line was once, when they called Ms. Valerie Wong, Jasmine's Senior Director of Legal and Business Affairs. If the Voicemail was made during this call, then it was an inadvertent disclosure by counsel.

This case is clearly controlled by *State Fund v. WPS*, *supra*, wherein the court stated:

Based on the language of Evidence Code section 912, we hold that "waiver" does not include accidental, inadvertent disclosure of privileged information by the attorney.

Thus, if there was an inadvertent disclosure it was by Gross's accidental operation of the telephone. There is no evidence that Banerjee or any other officer of Phenom

1	consented to the inadvertent disclos	sure. A wrongful electronic capture of privileged		
2	information is not voluntary, but coerc	ive to the holder of the privilege.		
3	E.	Relief Sought		
4	For the reasons set forth, Plaintiff	respectfully requests (1) an order sealing the		
5	Voicemail and providing that it may no	ot be considered, heard, or read in this proceeding		
6	and (2) for a preliminary injunction restraining use or disclosure in any format, whether			
7	electronic or written transcript, of the	Voicemail and its contents in any future pleading		
8	or proceeding.			
9	Dated: February 27, 2007	MADISON AND SUTRO		
10				
11		<u>Lisa Fong</u>		
12		By Lisa Fong, Esq.		
13 14		Attorneys for Plaintiff		
15				
16				
17				
18				
19				
20				
21				
22				
23				
24				
25				
26				
27				

TUESDAY AFTERNOON FEBRUARY 27, 2007

California
Bar
Examination

Performance Test A LIBRARY

PHENOM NETWORKS v. JASMINE SEMICONDUCTOR

LIBRARY

Selected Provisions of the Columbia Evidence Code	1
State Fund v. WPS, Inc. (Columbia Court of Appeal, 1999)	4
Hopwood Oil Exploration v. Nahama Exploratory Company (Columbia Court of Appeal, 1988)	9

SELECTED PROVISIONS OF THE COLUMBIA EVIDENCE CODE

§ 912. Waiver of privilege. Except as otherwise provided in this section, the right of any person to claim a privilege provided by section 954 (lawyer-client privilege) is waived with respect to a communication protected by the privilege if any holder of the privilege, without coercion, has disclosed a significant part of the communication or has consented to disclosure made by anyone. Consent to disclosure is manifested by any statement or other conduct of the holder of the privilege indicating consent to the disclosure, including failure to claim the privilege in any proceeding in which the holder has the legal standing and opportunity to claim the privilege.

LAW REVISION COMMISSION COMMENTS: This section states the general rule that the privilege is waived in one of two ways: the holder of the privilege may waive it by making an uncoerced disclosure, or waiver may occur by the holder's intentional consent to disclosure by a third party. If disclosure is made by the privilege holder, intent to waive the Reckless, negligent, accidental, as well as privilege is not required. conscious relinquishment by the privilege holder, can result in a waiver. In People v. Castro, Columbia, 1975, a court reporter was permitted to testify to a conversation which he overheard between a client and his attorney during a recess; the conversation was privileged because the client was not aware that the conversation was overheard, and "no question of surreptitious eavesdropping [was] presented," but the privilege was waived by the uncoerced, inadvertent, even unknown disclosure by the privilege holder. Under this view, inadvertent disclosures result in waiver because strict liability suffices to disclosures by the privilege holder. (8 Wigmore on Evidence, 3d ed., § 2326, 1940.)

* * *

§ 915. Disclosure of privileged information or attorney work product in ruling on claim of privilege. The presiding officer may not require disclosure of

information claimed to be privileged under section 954 (lawyer-client privilege) in order to rule on the claim of privilege.

LAW REVISION COMMISSION COMMENTS: Section 915 is solely applicable to claims of privilege where the information has not been previously disclosed. It has no applicability where the communication has been disclosed. In *Roe v. Superior Court*, Columbia, 1991, the Court of Appeal held that where the "confidential material has already been disclosed, the superior court did nothing to force the disclosure of previously undisclosed communications, and accordingly the superior court did not violate Evidence Code section 915." Similarly in *Klang v. Shell Oil Co.*, Columbia, 1971, where an attorney disclosed to an investigating police officer allegedly privileged information, without the client's consent, the court ruled that section 915 did not apply "because the disclosure had already occurred without action of any kind by the court."

* * *

§ 917. Presumption that certain communications are confidential. Whenever a privilege is claimed on the ground that the matter sought to be disclosed is a communication made in confidence in the course of the lawyer-client relationship, the communication is presumed to have been made in confidence and the opponent of the claim of privilege has the burden of proof to

establish that the communication was not confidential.

LAW REVISION COMMISSION COMMENTS: When a party asserts the attorney-client privilege, it is incumbent upon that party to prove the preliminary fact that a privilege exists. Once the foundational facts have been presented, i.e., that a communication has been made "in confidence in the course of the lawyer-client relationship," the communication is presumed to have been made in confidence, and "the opponent of the claim of privilege has the burden of proof to establish that the communication was not confidential," or that an exception exists.

* * *

§ 952. Confidential communication between client and lawyer. As used in this article, "confidential communication between client and lawyer" means information transmitted between a client and his or her lawyer in the course of that relationship and in confidence by a means which, so far as the client is aware, discloses the information to no third persons other than those who are present to further the interest of the client in the consultation or those to whom disclosure is reasonably necessary for the transmission of the information or the accomplishment of the purpose for which the lawyer is consulted, and includes a legal opinion formed and the advice given by the lawyer in the course of that relationship.

LAW REVISION COMMISSION COMMENTS: Whether a communication between a client and attorney is "in confidence" turns on the client's state of mind or consciousness; the test is whether the client was aware that the communications were disclosed to persons who were not entitled to it, not whether he or she should have been aware.

* * *

§ 956. Exception: Crime or Fraud. There is no privilege under this article if the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit a crime or a fraud.

LAW REVISION COMMISSION COMMENTS: Section 956 codifies the common law rule that the privilege protecting confidential attorney-client communications is lost if the client seeks legal assistance to plan or perpetrate a crime or fraud. The crime-fraud exception expressly applies to communications ordinarily shielded by the attorney-client privilege by Evidence Code section 954.

State Fund v. WPS, Inc.

Columbia Court of Appeal, 1999

Adam Telanoff, counsel for WPS, Inc., received copies of State Fund Compensation Insurance's (State Fund) internal documents containing privileged attorney-client communications because State Fund's outside lawyers inadvertently sent them along with other documents produced for use at trial. State Fund had produced for discovery approximately 7,000 pages of documents. Erroneously included were 273 pages of "Civil Litigation Claims Summaries" prepared by employees of State Fund. The heading at the top of each claim form reads: "ATTORNEY-CLIENT COMMUNICATION / ATTORNEY WORK PRODUCT." The word "CONFIDENTIAL" is repeatedly printed around the perimeter of the page of the form.

Telanoff gave some of the privileged documents to an expert witness he consulted for the WPS matter. The expert witness then provided those documents to another lawyer who was pursuing a different claim against State Fund, who used the documents to formulate a discovery request for the production of the claims forms. Counsel for State Fund in the other case was able to trace the claims forms back to the documents produced to Telanoff. In the meantime the WPS case was tried to a jury, resulting in a verdict in favor of State Fund.

State Fund's counsel then requested that the documents be returned, but Telanoff refused. State Fund's counsel then gave Telanoff ex parte notice that he would appear and seek an order for return of the documents. The court heard arguments and testimony regarding the confidential nature of the documents, and entered its order, finding that the claims forms were privileged, were inadvertently produced, and the production did not waive the privilege. The court further found that Telanoff's refusal to return the documents was in violation of counsel's ethical obligations and imposed monetary sanctions.

The primary question presented by this appeal is what is a lawyer to do when he or she receives through the inadvertence of opposing counsel documents plainly subject to the attorney-client privilege? Before answering the abstract question posed, we must first consider the predicate issues of whether the documents here did in fact contain privileged information and whether the inadvertent disclosure of the documents resulted in a waiver of the attorney-client privilege that would excuse any use of the document by the receiving attorney.

Based on the testimony from State Fund's general counsel it clearly appears that the claims forms contained confidential communications between State Fund and its counsel. She testified that the forms were intended by State Fund as a means of confidential communications between its claims department and its in-house lawyers. The forms were used by the legal department to communicate with claims agents, to identify issues, and then for the legal department to communicate the action that the agents should take in cases. The claims forms were also used by the legal department to assess the strengths and weaknesses of cases and then to communicate this to management of State Fund. According to the general counsel the claims forms typically contained summaries of counsel's assessments of the outcome of cases, settlements, and legal positions.

Evidence Code section 912 provides that the privilege is waived if the holder of the privilege discloses the communication or consents to the disclosure by another. The statute clearly provides that it is the holder of the privilege, in this case the client State Fund, who may waive the privilege, either by disclosing or conduct that consents to the disclosure. The language of the statute indicates that we are to look to the words and conduct of the holder of the privilege to determine whether a waiver has occurred. In this case, it is clear that State Fund did not itself disclose to appellants the claims summaries, but rather its counsel effected the inadvertent disclosure. We therefore focus on whether any statement or conduct of State Fund indicates that it consented to counsel's disclosure.

State Fund had no intention to disclose nor any role in the disclosure by its counsel. There is nothing indicating that State Fund participated in selecting the documents for production in the WPS litigation. It was unaware of the inadvertent disclosure and in no way demonstrated its consent to the disclosure. Also, the promptness with which counsel for State Fund moved to secure return of the documents indicated that there was no intent on the part of State Fund to waive the privilege. It is clearly demonstrated that State Fund had no intention to voluntarily relinquish a known right.

Based on the language of Evidence Code section 912, we hold that "waiver" does not include accidental, inadvertent disclosure of privileged information by the attorney. Telanoff invites us to adopt a "gotcha" theory of waiver, in which an underling's slip-up in a document production becomes the equivalent of actual consent. We decline. The substance of an inadvertent disclosure under such circumstances demonstrates that there was no voluntary release.

Telanoff contends that even if the documents were privileged and the privilege was not waived, that sanctions were not properly awarded because his conduct was not clearly proscribed by the law of this state. He contends that the case of *Aerojet Corp. v. Transport Indemnity* (Columbia, 1993) is substantially similar to the one before us and compels a reversal of the sanction order. In *Aerojet*, an attorney received a packet which included a document prepared by an opposing counsel. The document was not marked confidential, but it was "undeniably a privileged communication between opposing counsel and his client." The document revealed the existence of a witness who would have knowledge about matters involved in the lawsuit. The receiving attorney kept receipt of the document secret, and then deposed the witness. After the trial, in which a jury found against the client of the receiving attorney, the court imposed monetary sanctions for failure to disclose receipt of the document. The Columbia Court of Appeal reversed the sanction order.

Telanoff relies on this language from *Aerojet*.

We think that the manner in which counsel obtained the information in this case -- through documents inadvertently transmitted to him -- is irrelevant to resolution of the issue. Assuming no question of waiver, the problem would be no different if counsel had obtained the same information from someone who overheard the matter in a restaurant or a courthouse corridor, or if it had been mistakenly sent to him through the mail or by facsimile transmission. Once he had acquired the information in a manner that was not due to his own fault or wrongdoing, he cannot purge it from his mind. Indeed, his professional obligation demands that he utilize his knowledge about the case on his client's behalf. *Aerojet Corp. v. Transport Indemnity, supra.*

Without adopting this broad statement, we note that the actual basis of the Court of Appeal's decision in *Aerojet* was that the information used by counsel, the existence and identity of a potential witness, was non-privileged and would have been subject to discovery. As the court itself stated in *Aerojet*:

Consequently, whether the existence and identity of a witness or other non-privileged information is revealed through formal discovery or inadvertence, the end result is the same: the opposing party is entitled to the use of that witness or information. This fundamental concept was lost in the skirmish below. *Aerojet Corp. v. Transport Indemnity, supra.*

The facts in *Aerojet* are simply very different from those before us. The claims forms were privileged and conspicuously labeled as confidential. State Fund has demonstrated that the claims forms have been disseminated to other lawyers, and unless preventive measures are taken, State Fund could expect to be regularly subjected to requests for production in other cases.

We are particularly concerned with preserving confidentiality given the burgeoning of multi-party cases, the availability of xerography and the proliferation of facsimile machines and electronic mail that make it technologically ever more likely that through inadvertence, privileged or confidential materials will

be produced to opposing counsel by no more than the pushing of the wrong speed dial number on a facsimile machine.

Accordingly, we hold that the obligation of an attorney receiving privileged material is as follows: When a lawyer who receives materials that obviously appear to be subject to an attorney-client privilege or otherwise clearly appear to be confidential and privileged and where it is reasonably apparent that the materials were provided or made available through inadvertence, the lawyer receiving such materials should refrain from examining the materials any more than is essential to ascertain if the materials are privileged, and shall immediately notify the sender that he or she possesses material that appears to be privileged. The parties may then proceed to resolve the situation by agreement or may resort to the court for guidance with the benefit of protective orders and other judicial intervention as may be justified. We do, however, hold that whenever a lawyer ascertains that he or she may have privileged attorney-client material that was inadvertently provided by another, that lawyer must notify the party entitled to the privilege of that fact, and refrain from using and return the privileged material.

The conclusion we reach is fundamentally based on the importance which the attorney-client privilege holds in the jurisprudence of this state. Without it, full disclosure by clients to their counsel would not occur, with the result that the ends of justice would not be properly served. We believe a client should not enter the attorney-client relationship fearful that an inadvertent error by its counsel could result in the waiver of privileged information.

The order imposing sanctions is affirmed.

Hopwood Oil Exploration v. Nahama Exploratory Company

Columbia Court of Appeal, 1988

The basic issue involved in this appeal is the proper standard for determining whether the party seeking discovery of an otherwise privileged attorney-client communication has made the prima facie showing of crime or fraud required to negate the privilege.

Respondent Nahama Exploratory Company (Nahama) claims it had unique, confidential geological ideas based on many years of research and analysis to develop underground oil and gas reserves in an area known in the industry as the Bakersfield Arch controlled by Tenneco Oil Company (Tenneco). To persuade Petitioner Hopwood Oil Exploration (Hopwood) to participate in a large-scale exploration venture in the Arch area, Nahama disclosed confidential information about five prospects on Tenneco land and other prospects on adjoining property. Nahama delivered maps, montages and other proprietary data to Hopwood for its use in evaluating the proposal.

After Nahama introduced geologists of Hopwood to Tenneco, Hopwood's chief geologist called Nahama and said that Hopwood was not interested in the Nahama proposal.

Nahama learned of a Hopwood-Tenneco exploration agreement when it was announced in trade publications months later and threatened to sue because of its exclusion from the exploration agreement, claiming that based on the discussions of the parties and the industry custom that there was an implied agreement that Nahama would participate in the Tenneco venture.

Because of the threat of litigation, Mike Brownhill, Hopwood's vice president in charge of exploration, asked Frederick Dorey, Hopwood's general counsel, to assist Brownhill in investigating Nahama's claims. Sometime during the investigation, Dorey sent a report to Hopwood officers regarding the investigation.

Thereafter, Rod Nahama met with Brownhill, Dorey, and Hopwood's chief geologist to discuss each side's position. After the meeting, Brownhill prepared a memorandum summarizing the meeting and sent copies to other Hopwood personnel for their evaluation. General counsel Dorey reviewed and approved the memorandum.

At the conclusion of the investigation and with the approval of general counsel Dorey, Brownhill wrote Nahama on December 23, 1985, denying that Nahama had any right to participate in the Tenneco agreement and stating various reasons for his conclusion. Nahama contends the December 23, 1985 letter contains several misrepresentations of fact which were aimed at convincing Nahama that the confidential information Nahama provided to Hopwood did not contribute to Hopwood's decision to proceed with the Tenneco exploration agreement. Nahama sought discovery of the report prepared by Dorey, Hopwood's general counsel, and the memo by Brownhill, prepared at the direction of general counsel Dorey, and describing the meeting with Nahama.¹

Respondent court granted the motion finding Nahama had made a prima facie showing of fraud so the attorney-client privilege did not apply.

To invoke the Evidence Code section 956 exception to the attorney-client privilege, the proponent must make a prima facie showing that the services of the lawyer "were sought or obtained" to enable or to aid one to commit or plan to commit a crime or fraud.

Mere assertion of fraud is insufficient; there must be a showing that the fraud has some foundation in fact. A prima facie case is one which will suffice for proof of a particular fact unless contradicted and overcome by other evidence. In other words, evidence from which reasonable inferences can be drawn to establish the fact asserted, i.e., the fraud.

10

¹ The contents of these documents have not been disclosed to either the trial court or this court. Columbia Evidence Code § 915.

Hopwood submits Nahama must show each element of a fraud cause of action to make a prima facie case -- a false representation as to a material fact, knowledge of its falsity, intent to defraud, justifiable reliance and resulting damage. Since Nahama was not misled by the allegedly false statements in the December 23 letter, Hopwood argues there is no showing of reliance or damages by Nahama.

Hopwood's argument, however, misses the point. Evidence Code section 956 does not require a completed fraud. It applies to attorney communications sought to enable the client to plan to commit a fraud, whether the fraud is successful or not. Moreover, we are not reviewing the merits of a fraud cause of action (none of the causes of action allege a fraud) but rather we are reviewing the merits of a discovery order to determine if Nahama will have access to communications between Hopwood and its attorneys to aid Nahama in proving its causes of action. Without passing judgment in any way on the truth or falsity of the fraud allegations, it is entirely possible that Hopwood could have planned to commit a fraud when it investigated and sought legal advice from its attorneys on Nahama's claim in November 1985, i.e., that Hopwood intended to use the attorney's advice to avoid liability to Nahama by falsely representing the facts concerning the use of Nahama's confidential data in putting together the Tenneco deal. If this is shown, then Hopwood has forfeited the benefits of the attorney-client privilege for discovery purposes even though Nahama has not shown at this stage of the proceedings that it relied on and suffered damages from the misrepresentations contained in the December 23 letter.

We conclude that because section 956 applies where an attorney's services are sought to enable a party to plan to commit a fraud, the proponent of the exception need only to prove a false representation of a material fact, knowledge of its falsity, intent to deceive and the right to rely.

Nahama points to several alleged misstatements in the December 23 letter. The first statement reads: "The only proposals for a joint venture with Nahama that were considered by Hopwood were your suggestions for participation in Tejon

Ranch, the Arroyo Hondo, and English Colony exploration ventures." Nahama claims that Hopwood in fact considered additional areas for exploration that were proposed by Nahama.

Nahama presented documents received from Hopwood in response to Nahama's requests to produce that referred to three other prospects identified by Nahama. In addition, the documents showed Hopwood had prepared financial analyses of these additional prospects. Also, confidential maps and documents which were returned to Nahama were cut up, pasted, colored, marked up and annotated. Hopwood did not explain the alterations to Nahama. Nahama presented a map prepared by a Hopwood geologist that outlined areas for exploration that is substantially the same as the area outlined and recommended on the Nahama maps.

The next challenged statement reads: "After we declined your suggestions for the joint ventures, Hopwood determined to focus their onshore Columbia exploration efforts on the Stevens Sand within the Bakersfield Arch area. The major landowner in this area is Tenneco. Accordingly, Hopwood contacted Tenneco..."

Nahama interprets the paragraph to represent that Hopwood decided to go to Tenneco only after it had rejected Nahama's proposals. That representation is belied by documents prepared by its geologists stating that meetings with "Nahama produced very attractive prospects" and that these prospects were "currently under discussion between Nahama and Tenneco." And that "we understand that Tenneco does not know about this attractive play which has been identified on their land by Nahama. Reserves could be as high as 50 million barrels at a risk of one in five."

This evidence supports the conclusion that Hopwood intended to deceive Nahama into believing that Nahama's confidential information had nothing to do with the Tenneco agreement. It constitutes a prima facie showing the letter was an attempt to defraud Nahama and to dissuade it from pursuing its claims.

Finally, Hopwood contends that, even assuming a prima facie showing of fraud was made by the misrepresentations contained in the December 23 letter, Nahama did not establish that Hopwood engaged in the attorney-client communications in furtherance of the fraudulent scheme. In this case, Nahama proved that the Hopwood communications with counsel were made as part of the investigation that resulted in the fraudulent December 23 letter. This established the reasonable relationship between the subject matter of the fraud and the privileged communications. Mr. Dorey, Hopwood's corporate counsel, was made a member of the team investigating Nahama's claims to which the December 23 letter responded. This evidence permits a reasonable inference that the fraudulent scheme reflected in the December 23 letter evolved from the privileged communication.

We emphasize, again, that our holding is not to be construed in any way as an indication that the fraud inferences are true -- only that they exist from the present record.

The discovery order is affirmed.

THURSDAY AFTERNOON MARCH 1, 2007

California
Bar
Examination

Performance Test B
INSTRUCTIONS AND FILE

IN RE ERGOMETRIX, INC.

Instructions	. i
FILE	
Memorandum from Alma Martinez to Applicant	1
Excerpts of Transcript of Interview with Melinda Choy	3
Letter from Rankin Bayard III to Melinda Choy	8
Excerpts from Ergometrix, Inc.'s Employment Agreement	10
Excerpts from Ergometrix, Inc.'s Stock Option Plan	11

IN RE ERGOMETRIX, INC.

INSTRUCTIONS

- You will have three hours to complete this session of the examination.
 This performance test is designed to evaluate your ability to handle a select number of legal authorities in the context of a factual problem involving a client.
- 2. The problem is set in the fictional State of Columbia, one of the United States.
- You will have two sets of materials with which to work: a File and a Library.
- 4. The File contains factual materials about your case. The first document is a memorandum containing the instructions for the tasks you are to complete.
- 5. The Library contains the legal authorities needed to complete the tasks. The case reports may be real, modified, or written solely for the purpose of this performance test. If the cases appear familiar to you, do not assume that they are precisely the same as you have read before. Read each thoroughly, as if it were new to you. You should assume that cases were decided in the jurisdictions and on the dates shown. In citing cases from the Library, you may use abbreviations and omit page citations.
- 6. You should concentrate on the materials provided, but you should also bring to bear on the problem your general knowledge of the law. What you have learned in law school and elsewhere provides the general background for analyzing the problem; the File and Library provide the specific materials with which you must work.
- 7. Although there are no restrictions on how you apportion your time, you should probably allocate at least 90 minutes to reading and organizing before you begin preparing your response.
- 8. Your response will be graded on its compliance with instructions and on its content, thoroughness, and organization.



Martinez, Petit & Liefer, LLP Attorneys at Law

MEMORANDUM

TO: Applicant

FROM: Alma Martinez

DATE: March 1, 2007

SUBJECT: Ergometrix, Inc. – Schaeffer Stock Options

Melinda Choy, Chief Executive Officer of our client, Ergometrix, Inc. ("Ergometrix"), has asked for our advice on whether Arthur Schaeffer, who recently resigned from Ergometrix, can be prevented from accepting employment with a competitor and from exercising certain stock options issued to him pursuant to a company stock option plan. Mr. Schaeffer worked for Ergometrix as its Senior Vice President of Engineering and, despite his agreement that he would not do so, accepted a job with a competitor immediately upon his resignation. Also, at various times over the course of his employment, Mr. Schaeffer received stock options to acquire a total of 100,000 shares of Ergometrix common stock. As of the time of his departure, he had not exercised any of the options. He has now attempted to exercise the options and, through his attorney, has demanded that Ergometrix issue 100,000 shares to him.

Ergometrix has put a "hold" on Mr. Schaeffer's stock options pending receipt of our advice.

Your task is to draft for me an objective memorandum analyzing whether Mr. Schaeffer's agreement not to work for a competitor and the forfeiture provisions of the Ergometrix stock option plan are enforceable against Mr. Schaeffer.

Specifically, address the following issues:

- 1. Whether the covenant not to compete contained in the employment agreement is enforceable.
- 2. Whether Mr. Schaeffer can exercise any of his stock options, i.e.,
 - (a) Whether any and, if so, which of the stock option grants have lapsed by the passage of time.
 - (b) Whether the stock options are "wages" within the meaning of Columbia Labor Code section 200.
 - (c) Whether either the lapse or the forfeiture provisions in the stock option plan violate Columbia Labor Code sections 221 and 222.
 - (d) Whether the forfeiture effected by the noncompetition component of the stock option plan violates Columbia Civil Code section 1600.

Discuss all the issues and reach a reasoned conclusion on how each should be resolved.

EXCERPT OF TRANSCRIPT OF INTERVIEW WITH MELINDA CHOY

2	February 25, 2007
3	* * *
4	Alma Martinez ("Martinez"): So, the problem is twofold: first, that Arthur Schaeffer
5	violated his agreement not to go to work for a competitor and, second, that he wants
6	to exercise his stock options, and Ergometrix doesn't believe he's entitled to. Is that
7	right?
8	Melinda Choy ("Choy"): That's right. Mr. Schaeffer - Art - quit us at a crucial time
9	and went to work for Indonix, a major competitor of ours. I'd like to know if I can keep
10	him from working for Indonix, and I certainly don't want him to end up with 100,000
11	shares of our company.
12	Martinez: Well, I know you're about to launch your initial public offering - your IPO -
13	and Ergometrix stock will be offered on the market at \$10 a share. Is that what you
14	mean when you say Art left at a crucial time?
15	Choy: Yes, that and the fact that we're rolling out some new products he was
16	instrumental in developing and marketing.
17	Martinez: OK, let's go back to the beginning. What's the main issue as far as you're
18	concerned?
19	Choy: Well, it's prompted by a letter we got from Art's attorney - here it is. He's
20	basically claiming that we can't stop Art from working for Indonix, that the forfeiture
21	language in our stock option plan is void, and that Art has the right to exercise all his
22	options.
23	Martinez: Let's deal first with the fact that he's gone to work for Indonix. Why do you
24	think he shouldn't be allowed to do that?
25	Choy: Well, he signed our standard non-compete agreement – all our key employees
26	agree not to work for a competitor for six months after leaving Ergometrix. Art was
27	one of our original employees when we started up the company eight years ago - that
28	was in 1999. He was a very talented product engineer, and he moved up steadily in

- the ranks and ended up as one of our key executives. Here's the employment
- 2 contract he signed containing that agreement.
- 3 Martinez: Were any of the terms of Art's employment covered by a union contract?
- 4 **Choy:** No, we've never been unionized.
- 5 Martinez: What are you concerned about that Art will give up your trade secrets to
- 6 Indonix or issues like that?
- 7 Choy: No, not really. Our customers, pricing, and products are pretty much in the
- 8 public domain, so there's not much harm he can do to us on that score. It's just that
- 9 he'll give Indonix a competitive advantage because of his engineering talents.
- 10 Martinez: OK. Let's talk about the stock options. How did Art acquire the options?
- 11 **Choy:** Like most high-tech start-up companies, we used stock options to create
- incentives for our employees, you know, to give them a stake in what we hoped would
- 13 be our success. At different times, Art received five separate stock option grants
- 14 under our stock option plan 20,000 shares each time. The option prices were
- anywhere from 50¢ to \$2.00 a share. In other words, each grant gave him the right to
- buy 20,000 shares at whatever the option price was in that particular grant.
- 17 **Martinez:** So, by exercising the options at the option prices, he could buy the shares
- 18 for just a fraction of the \$10 per share the stock will be offered for when the IPO goes
- 19 through.
- 20 **Choy:** That's right. I mean, the underwriters have set the opening IPO share price at
- 21 \$10 it might be lower or higher, depending on how the market reacts. For sure, it
- will be more than Art's option prices, and he stands to make a killing.
- 23 **Martinez:** What's the harm if you just let him exercise the options?
- 24 **Choy:** The harm is that he will end up holding 100,000 Ergometrix shares. This is
- especially a problem because he's now working for Indonix, a head-on competitor of
- 26 ours. But even if he just turns around and sells the stock at the market price, he will
- 27 end up with about a million dollar windfall. He shouldn't be able to breach his contract
- with us and then get rich at our expense. And, if he gets away with it, what's to stop
- 29 others from doing the same thing?

- 1 **Martinez:** You've got a good point there. The letter from Art's attorney says the stock
- 2 options were part of Art's wages. Is that right?
- 3 **Choy:** You know, we never thought of it in those terms. He received a fairly high salary
- 4 and the usual fringe benefits health insurance and vacation that's what we figured
- 5 his compensation was. It's not like he gets the stock for free. He has to put up his
- 6 own money to exercise the options, so I don't see how it can be considered part of his
- 7 pay. The stock options were really intended as an incentive to stay with the company
- 8 and give him a stake in making it a success. If we succeeded, which we did, he could
- 9 share the wealth. If we had failed, the options would have been worthless. So he
- 10 took a chance along with the rest of us.
- 11 **Martinez:** How did you determine whether an employee would receive option grants
- 12 and how large the grants would be?
- 13 **Choy:** We the board of directors met periodically and decided who the key
- employees were and roughly how many options shares to grant to each one.
- 15 **Martinez:** What guidelines or criteria did you apply?
- 16 Choy: Nothing very definite. We started out as a very small company, and we're still
- 17 not very large. We know who's doing a good job for us and who isn't just a general
- 18 sense of how valuable the particular employee was and what he or she had
- 19 accomplished for the company. Art was always a hard worker and top producer, so
- 20 he got fairly large grants.
- 21 Martinez: Did the options depend to any degree on how much work he produced or
- 22 how many hours he worked? In other words, how was it decided when and how many
- 23 options he'd get?
- 24 **Choy:** No. They had nothing to do with volume or hours of work by Art or anyone else.
- 25 The timing and the size of the options pretty much depended on what we thought it
- would take to keep our key people committed. Of course, we wanted to be sure that
- whoever got stock options was a good, hard working employee.

- 1 Martinez: Let's take it a piece at a time. First, were Schaeffer's options vested? In
- 2 other words, was there any reason he couldn't have exercised them while he was still
- 3 working for you?
- 4 Choy: I don't think so. You can look at the stock option plan and figure that out. But
- 5 Art never attempted to exercise any of them while he was still with us.
- 6 Martinez: Why do you suppose that is?
- 7 Choy: We all knew we were eventually going to take Ergometrix public and that the
- 8 stock would shoot up in value, so maybe he didn't think it made much sense to put out
- 9 his own money to buy the shares before he really had to. Besides, I think some of the
- options have lapsed by now. I think that's somehow stated in the Plan.
- 11 **Martinez:** Why would Art have let any of them lapse?
- 12 Choy: Probably just by inadvertence. In the early days we were all so busy and
- 13 focused on getting the business headed in the right direction that no one paid much
- attention to that. Plus, the business didn't look too promising, so I guess he thought it
- 15 wasn't worth the risk to pay the option price for stock that might end up being
- 16 valueless.
- 17 **Martinez:** What was the reason for having the lapse provisions?
- 18 **Choy:** Well, the idea was that it would induce employees to exercise the options, and
- 19 every time they did it would generate some cash for the company. It worked to some
- 20 extent but not very much.
- 21 **Martinez:** Did the company ever extend or renew any of the "lapsed" grants?
- 22 **Choy:** A couple of other employees came to me just before some of their grants
- 23 lapsed, and I signed extensions for them. I guess if Art had asked, I would've done it
- for him too, but he never asked, and I didn't even think anything about it.
- 25 **Martinez:** When did Art quit, and what were the circumstances?
- 26 **Choy:** He came in to my office about three weeks ago and told me that he'd received a
- 27 very attractive offer from Indonix and that he had accepted it. He gave two weeks
- notice and has been gone a week. He said he'd made up his mind and wouldn't even
- 29 discuss alternatives with me. When I reminded him about his non-compete

- agreement, he just laughed and said his attorney told him it wasn't worth the paper it
- was written on.
- 3 Martinez: Did you have any discussion with him about his stock options?
- 4 Choy: Yes. I told him the Plan says his unexercised options which are all of his –
- 5 are rescinded. He said his attorney told him I couldn't rescind his unexercised
- 6 options, no matter what the forfeiture clause in the Plan says.
- 7 **Martinez:** Did he try to exercise the options?
- 8 Choy: Yes. He said he wanted to exercise them all immediately. He handed me a
- 9 letter so stating and his check for \$115,000 to cover the option prices. I gave him his
- letter and check back and told him, "Get lost!" And, you can see, he didn't waste any
- 11 time in getting his attorney to write us a nasty letter.
- 12 **Martinez:** Is the information in the letter from Art's attorney accurate as to the dates,
- 13 amounts, and option prices?
- 14 **Choy:** Yes, and the tender of \$115,000 is the correct amount if we have to allow him
- to exercise all the options.
- 16 **Martinez:** Is this the first experience you've had with someone leaving and wanting to
- 17 exercise his stock options? I mean have you ever had to invoke the forfeiture
- 18 provisions before?
- 19 **Choy:** No, it's the first time this has happened.
- 20 **Martinez:** All right. Let me look into it, and I'll get back to you in a few days with an
- 21 answer. I know that a federal court, in a case called Ball v. International Machinery
- 22 Corp., recently dealt with some of these issues and certified to the Columbia Supreme
- 23 Court the guestion whether stock options are wages. But the parties settled the case
- 24 and mooted the question before the Columbia court had a chance to decide the issue.
- 25 So this may be a matter of first impression.
- 26 **Choy:** Thanks. I'll look forward to hearing from you.
- 27 END OF INTERVIEW

Law Offices of Rankin Bayard III

44 Melton Plaza, Suite 2400 Anniston, Columbia 94501 (490) 531-4333

February 24, 2007

Melinda Choy Chief Executive Officer Ergometrix, Inc. 820 Miramar Parkway, Building 5 Anniston, Columbia 94502

Re: Arthur Schaeffer – Stock Options

Dear Ms. Choy:

I write on behalf of my client, Arthur Schaeffer, to demand that Ergometrix, Inc. honor Mr.

Schaeffer's request to exercise all five grants of stock options awarded to him while in the employ of Ergometrix.

In the eight years of Mr. Schaeffer's employment with your company, he earned and was awarded the following stock option grants:

1st Grant: May 1, 1999 – 20,000 shares @ 50¢ per share; fully vested

as of August 1, 1999

2nd Grant: May 1, 2000 – 20,000 shares @ 75¢ per share; fully vested

as of August 1, 2000

3rd Grant: May 1, 2002 - 20,000 shares @ \$1.00 per share; fully

vested as of August 1, 2002

4th Grant: October 1, 2004 – 20,000 shares @ \$1.50 per share; fully

vested as of January 1, 2005

5th Grant: July 1, 2005 – 20,000 shares @ \$2.00 per share; fully vested

as of October 1, 2005

On February 8, 2007, Mr. Schaeffer announced his resignation to accept employment with Indonix, an acknowledged competitor of Ergometrix, and his intention to exercise

all outstanding stock options. You crassly told him that Ergometrix would refuse to honor the options. I can only assume that, in refusing to honor the options, you were relying on the forfeiture provisions contained in the stock option plan. Those provisions are unlawful and unenforceable for the following reasons.

First, the stock options constitute "wages" as that term is defined in Columbia Labor Code § 200. They were fully vested, and, under the 1982 holding of the Columbia Supreme Court in *Suarez v. Dressers, Inc.*, any forfeiture of earned and vested wages is unlawful.

Second, both the lapse and forfeiture provisions violate Columbia Labor Code § 221, also because the options are fully vested wages. Those provisions also violate Columbia Labor Code § 222 because they constitute an unlawful withholding of wages previously agreed to.

Third, the provision in the stock option plan that calls for a forfeiture in the event a participant becomes employed by a competitor of Ergometrix violates Columbia Civil Code § 1600, which voids any contract to the extent that it restrains a person from engaging in a lawful profession, trade, or business. The obvious effect of the forfeiture provision is to restrain Mr. Schaeffer from accepting employment with a competitor. Such "covenants not to compete" are void and unenforceable as a matter of public policy in Columbia. *McGill v. Donald Reuben Corp.*, Columbia Supreme Court (1965).

Finally, if you have any inclination to try to challenge Mr. Schaeffer's having accepted employment with Indonix, please disabuse yourself of that notion. The noncompetition clause of your standard employment agreement is a blatant violation of Columbia Civil Code § 1600. Any effort on your part to disrupt his relationship with Indonix will be resisted vigorously.

On behalf of Mr. Schaeffer, I hereby tender the sum of \$115,000 to cover the cost of exercising the options on all 100,000 shares, and I demand that you forthwith issue 100,000 shares to Mr. Schaeffer.

I am authorized by Mr. Schaeffer to file suit against Ergometrix to enforce the options if I have not received a satisfactory response from you within 30 days of the date of this letter.

Very truly yours,

Rankin Bayard III

Rankin Bayard III

EXCERPTS FROM ERGOMETRIX, INC.'S EMPLOYMENT AGREEMENT

* * *

Sec. 22. COVENANT NOT TO COMPETE

EMPLOYEE agrees that during the term of his employment and for a period of six months after the termination thereof, whether said termination be voluntary or involuntary, he will not render, directly or indirectly, any services, whether as an employee or otherwise, to any business that is a competitor of Ergometrix. This covenant not to compete is voluntarily undertaken by EMPLOYEE at the time of his initial employment.

* * *

Date: February 2, 1999

Employee

Arthur Schaeffer

EXCERPTS FROM ERGOMETRIX, INC.'s STOCK OPTION PLAN

Sec. 1.01 – Purpose: Ergometrix, Inc. promulgates this Stock Option Plan to gain the commitment of its key employees to the success of the company. Its purpose is to allow the employees to acquire an ownership interest in the company through the investment of their own time, effort and money and to give them the opportunity to share in the success and growth of the company.

* * *

Sec. 4.01 – Vesting: The right to exercise all options granted pursuant to this Plan shall fully vest in the Participant to whom the grant is awarded three months after the date of the grant. "Vesting" shall mean that, subject to the lapse and forfeiture provisions of this Plan, the Participant shall have the right to exercise the option at the stated option price, whereupon the company shall issue to the Participant the number of Common Class A shares stated in the grant so exercised.

Sec. 4.02 – Exercise: At any time after vesting of any grant awarded hereunder, the Participant shall have the right to exercise the option to acquire up to the number of shares stated in the grant. "Exercise" means a timely tender to Ergometrix by the Participant of the option price for the number of option shares the Participant wishes to acquire accompanied by a written demand that Ergometrix issue said shares to the Participant.

Sec. 4.03 – Lapse: Unless the Participant exercises an option granted hereunder within three years of the date of the grant, all rights conferred by said grant shall lapse, and, unless the grant is expressly renewed or extended, the Participant shall lose all rights thereunder.

* * *

Sec. 8.01 – Forfeiture of Options: The Participant under this Plan understands and agrees that in the event a Participant directly or indirectly accepts employment with, or performs any work for, any person or entity that is engaged in the same line of business and in competition with Ergometrix, either while the Participant is employed by Ergometrix or within six months after the Participant's termination of employment with

Ergometrix, all unexercised grants awarded to the Participant shall be deemed rescinded and all rights of the Participant thereunder surrendered.

THURSDAY AFTERNOON MARCH 1, 2007

California
Bar
Examination

Performance Test B LIBRARY

IN RE ERGOMETRIX, INC.

LIBRARY

Excerpts from the Columbia Labor Code	1
Excerpt from the Columbia Civil Code	2
McGill v. Donald Reuben Corp. (Columbia Supreme Court, 1965)	3
Suarez v. Dressers, Inc. (Columbia Supreme Court, 1982)	5
Ball v. International Machinery Corp. (United States Court of Appeals, 15 th Circuit, 2005)	9

EXCERPTS FROM THE COLUMBIA LABOR CODE

Section 200. Wages

As used in this Code, the term "wages" includes all amounts for labor of every kind or description performed by employees, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation.

* * *

Section 221. Repayment of Wages to Employer

It shall be unlawful for any employer to receive from an employee any part of wages theretofore paid by said employer to said employee.

Section 222. Withholding of Part of Wage

It shall be unlawful, in the case of any wage agreement arrived at through collective bargaining, for an employer to withhold from any employee any part of the wage agreed upon.

* * *

Section 227. Vested Vacation Wages

Unless provided by a collective bargaining agreement, whenever a contract of employment or employer policy provides for paid vacation and an employee is terminated without having taken off his vested vacation time, all vested vacation shall be paid to him as wages at his final rate of pay; provided, however, that an employment contract or employer policy shall not provide for forfeiture of vested vacation time upon termination.

* * *

Section 407. Investment in Business in Connection with Employment

Investments and the sale of stock or an interest in a business in connection with the securing of a position are illegal as against the public policy of this State and shall not be advertised or held out in any way as part of the consideration for any employment.

EXCERPT FROM THE COLUMBIA CIVIL CODE

Section 1600. Unauthorized Contracts

Every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.

McGill v. Donald Reuben Corp.

Columbia Supreme Court (1965)

Plaintiff appeals from an adverse judgment in an action for declaratory relief to establish his right to be reinstated in the employees' retirement plan of the defendant corporation.

Plaintiff left defendant's employ on July 1, 1960, after meeting all the requirements for benefits under the retirement plan. On October 24, 1960, he went to work for a competitor of the defendant. On December 5, 1960, the retirement committee that administers the plan notified plaintiff that his rights to receive payments had been terminated pursuant to section 7.1 of the plan on the ground that he had entered the employ of a competitor. Plaintiff then brought this action against the corporation seeking a declaration that he was entitled to reinstatement on the ground that the section invoked by the retirement committee was against public policy and unenforceable. The trial court held that section 7.1 was valid.

Section 1600 of the Columbia Civil Code provides that "Every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void." This section invalidates provisions in employment contracts prohibiting an employee from working for a competitor after leaving his employment with his previous employer or imposing a penalty if he does so. The pension plan is part of an employee's contract of employment. See *Bos v. U.S. Rayon Co.*, Columbia Court of Appeals (1958).

As this Court said long ago in *Car-Na-Var-Corp. v. Mossler*, Columbia Supreme Court (1944):

Section 7.1 provides: "The annuity payments to any retired Employee shall be suspended or terminated in the event such retired Employee at any time enters any occupation or does any act which, in the judgment of the Retirement Committee, is in competition with any phase of the business of the Employer."

Equity will to the fullest extent protect the property rights of employers in their trade secrets and the preservation of their hard-won business advantages, but public policy and natural justice require that equity should be solicitous for the inherent right in all people, not fettered by negative covenants upon their part to the contrary, to follow any of the common occupations of life. A former employee has the right to engage in a competitive business for himself and to enter into competition with his former employer, even for the business of those who had been the customers of his former employer, provided such competition is fairly and legally conducted.

That principle emanates from the common law and is embodied in section 1600 of the Civil Code. It is true that a number of states have abandoned the common law prohibition of covenants restraining competition in employment agreements, adopting instead an approach enforcing such covenants to the extent they are reasonable. It may even be correct to say that this "rule of reason" represents a majority rule among jurisdictions that have considered the question.

However, the Columbia courts, led by this court, have been clear in their expression that section 1600 represents a strong public policy of the state that should not be diluted by judicial fiat.

The forfeiture imposed upon the plaintiff by the defendant corporation in this case therefore violates section 1600.

The judgment is reversed.

Suarez v. Dressers, Inc.

Columbia Supreme Court (1982)

At issue is the question of when vacation time becomes "vested" under Columbia Labor Code § 227, which provides, essentially, that upon termination an employee is entitled to receive pay for all vested vacation time and that "an employment contract or employer policy shall not provide for forfeiture of vested vacation time upon termination."

Emilio Suarez was employed by Dressers, Inc., a non-union employer, from December 1, 1972 until July 1, 1978, at which time he was laid off in a general reduction in Dressers' workforce. Throughout the period of his employment, Suarez received an hourly wage for the hours he worked each week. In addition, he received certain fringe benefits, including holiday and vacation pay.

The company's vacation policy provided that each hourly employee was entitled to between one and four weeks of paid vacation annually, depending on the length of his or her employment. Under the policy, an employee did not become eligible for a paid vacation until the anniversary date of his or her employment; vacation must be taken during the year of eligibility; vacation could not be carried over from one year to the next; and employees were not entitled to receive pay in lieu of vacation.

Suarez regularly took his accumulated vacation time through December of 1977, at which time his length of service was such that he was in the three-weeks-per-year

¹ Suarez also invokes Labor Code §222, which forbids an employer from withholding any part of earned wages "arrived at through collective bargaining." We dismiss this claim inasmuch as Suarez's employer was non-union, and his wages were not subject to a collective bargaining agreement.

eligibility category. However, from December 2, 1977 until the date of his termination in July 1978, he did not take any paid vacation time.

On July 1, 1978, the company paid Suarez a final paycheck covering his accumulated hourly wage but refused to pay him anything for pro-rated vacation pay. The company's position was none of Suarez's vacation pay "vested" until his next anniversary date of December 1, 1978 and, since he was not employed on his anniversary date, he had no "vested vacation time."

Suarez asserted in the court below that his annual paid vacation was a form of wages earned for labor performed throughout the year and "vested" as it was earned. He claimed that, as an employee who worked for some part of a year, he had a "vested" right to a proportionate share of his vacation pay at the time of termination. The court below ruled in his favor.

When considering the meaning of the phrase "vested vacation time" as used in § 227, it is important to keep in mind the nature of vacation pay. It is well established that vacation pay is not a gift or gratuity but is, in effect, additional wages for services performed. The consideration for annual vacation is the employee's year-long labor. Only the time of receiving these "wages" is postponed until the employee goes on vacation. This court has adopted the view that vacation pay is a form of deferred compensation in the form of a reward of additional wages for constant and continuous service. In the modern economy, employers have devised increasingly complex use of compensation in the form of "fringe benefits," some types of which are not payable until a time subsequent to the performance of the work that earned the benefits.

Recently, this court had the occasion in *Maynard v. State of Columbia* (1980) to consider whether and when pension entitlements are a "vested right." We held that the right to pension benefits vests upon acceptance of employment, even though the right

to immediate payment of the pension may not mature until certain conditions are satisfied. The employee earns *some* pension entitlements as soon as he or she has performed some substantial services for the employer even though the payment of the pension earnings is to be made at a future date. The pension right continues to vest cumulatively as the work for which it is intended as compensation is performed. Although the right to a pension may still be, in whole or in part, subject to divestiture upon the happening of certain contingencies (e.g., insufficient length of service, employee's failure to pay required contributions), that does not prevent the right from vesting.

Likewise, the right to vacation pay, being a form of wages, vests cumulatively and proportionately as the employee performs his or her work for the employer. The requirement in Dressers' vacation policy that the employee must be employed on his or her anniversary date in order to be entitled to receive paid vacation does not prevent the vacation entitlement from accruing and vesting *pro rata*. At most, it is a condition that attempts to effect a forfeiture of vacation pay already vested. Unlike the situation with a pension plan, where there *may* be valid conditions that result in lawful forfeiture, ² Columbia law forbids the forfeiture of vested vacation pay, i.e., Labor Code § 227 specifically provides that "an employment contract or employer policy *shall not provide for forfeiture* of vested vacation time upon termination." (Emphasis added.)

Dressers argues that its policy requiring that an employee be employed on his or her anniversary date in order to be entitled to vacation pay is not a condition that effects a

² However, there are limits to circumstances under which forfeitures can lawfully occur. For example, in *McGill v. Donald Reuben Corp.* (1965), this court found invalid a retirement plan provision that made an employee's pension forfeitable if the retired employee at any time enters into any occupation or does any act in competition with the firm from which he retired. This provision, we held, violated Columbia Civil Code § 1600, which expresses a strong, immutable principle of Columbia public policy invalidating any contract that purports to restrain one from engaging in a lawful profession, trade, or business.

forfeiture. Rather, says Dressers, it is a condition that prevents those rights from vesting at all. That is to say, it is intended as an incentive to the employee to remain in the company's service and vacation pay is a reward for fulfillment of that condition. Dressers claims that failure of that condition prevents vesting.

There may very well be employer benefit and incentive plans that are designed to reward employees for remaining on the job for periods of time. Vacation pay is not one of them. If, in fact, vacation pay served simply to induce employees to remain on the job for a certain period of time, then interpreting Dressers' eligibility requirement as a condition would be entirely reasonable and the forfeiture would be lawful because the vacation time would not be vested. However, there are at least two flaws in the argument: first, it is not necessarily within the employee's control whether to remain employed until the anniversary date. In this case Suarez was laid off in a reduction in force prior to his anniversary date. Second, once it is acknowledged that vacation pay is part of the employee's wage, the justification for requiring the employee to remain employed for the entire year disappears. It would be like arguing that an employee who is terminated before payday is not entitled to receive the accrued wages earned up to the moment of termination because he was no longer employed on payday.

Accordingly, we hold that the right to a paid vacation constitutes deferred wages for services rendered that vests *pro rata* and that, once vested, is protected from forfeiture by § 227 and we affirm the judgment.

Ball v. International Machinery Corp.

United States Court of Appeals, 15th Circuit (2005)

In this case, we consider the question whether stock options granted by an employer to any employee are wages.

Dr. William Ball worked as a senior scientist in the research and development department of International Machinery Corp. (IMC) in Mayville, in the neighboring State of Olympia, which is where IMC is incorporated and headquartered. In the course of his employment, Dr. Ball acquired stock options issued by IMC. The options were worth more than \$900,000 when he exercised them. The IMC stock option plan included a promise that if an employee/participant worked for a competitor within six months after exercising the options, he would return to IMC all profits from the options. A week after exercising his options, Dr. Ball resigned from IMC and went to work for a competitor in Bay City, Columbia. IMC therefore notified him that his stock options were cancelled and demanded that he return the \$900,000 in profits.

Dr. Ball filed this suit for declaratory relief in the Columbia federal district court, seeking a declaration that the forfeiture provisions of IMC's stock option plan are unenforceable. Dr. Ball claims that the forfeiture provisions violate two provisions of Columbia law: Labor Code § 221, which makes it unlawful "for any employer to receive from an employee any part of wages theretofore paid by said employer to said employee," and Civil Code § 1600, which voids "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business." The trial court entered judgment for Dr. Ball on both claims.

Jurisdiction in Dr. Ball's suit is based on diversity of citizenship. Both Columbia and Olympia are within this, the 15th Circuit. The IMC stock option plan contains a choice of

law clause providing that any dispute arising under the terms of the plan shall be governed by the laws of the State of Olympia.

A. Choice of Law

The threshold question is whether the dispute is governed by the substantive law of Olympia as prescribed in the stock option plan, or, as Dr. Ball claims, by the substantive law of Columbia.

The choice of law question turns on whether the Columbia statutes in issue – Labor Code § 221 and Civil Code § 1600 – are applicable to the transaction and reflect fundamental public policies of the State of Columbia that would be impermissibly offended if the laws of Olympia were applied.

B. Columbia Labor Code §§ 200 and 221

As we have noted, § 221 makes it unlawful "for any employer to receive from an employee any part of wages theretofore paid by said employer to said employee." Dr. Ball's theory is that allowing IMC to recover the profits he made by exercising his stock options would be tantamount to allowing IMC to "collect or receive" from him "wages theretofore paid" to him. This statute, passed in 1937, has as its purpose the prevention of employers extracting "kickbacks" from employees and protecting employee expectations regarding receipt of the wages the employer has contracted to pay.

There is no question whatsoever that § 221 expresses a fundamental public policy in protecting the wages of employees in the State of Columbia. See *Alton v. Emery Iron Foundry*, Columbia Supreme Court (1956): ("The Legislature has expressed in the strongest possible terms this state's public policy that wages, once earned by and paid to employees, is theirs and cannot be taken back by the employer.")

The more difficult question, however, is whether stock options are "wages." The controlling law in the State of Olympia is that stock options are not "wages." The courts of Columbia have not considered this question, so this court has two choices on how to proceed on this issue: we can review tangentially related Columbia court decisions and other authorities and try to deduce therefrom how the Columbia courts would rule if confronted by the question; or we can certify this question of law to the Columbia Supreme Court pursuant to Columbia Appellate Rule 12.2 and request the Columbia court to determine it.

In Columbia, "wages" are defined in Labor Code § 200 as "all amounts for labor of every kind or description performed by employees, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation."

The courts in different states that have considered the question in the context of statutory language similar to that in § 200 have reached differing conclusions. For example, the courts of the State of Franklin, applying that state's Wage Payment and Collection Law, have concluded that stock options *are* wages "if the employer specifically agreed to deliver the option as employment compensation." The courts in Olympia, as we have noted, have determined the opposite – that stock options *are not* wages under any circumstances.

Although we do not pretend to suggest how the Columbia Supreme Court would ultimately rule on the question, we are inclined toward the view that stock options are not wages under § 200 because the concept underlying stock options does not seem to fit into the § 200 definition of "all *amounts* for *labor* of every kind or description performed by employees, whether the *amount is fixed* or ascertained by the *standard* of time, task, piece, commission basis, or other method of calculation." (Emphasis added.) Parsing the statute and examining it in terms of the words we have italicized tends to

demonstrate what we mean when we say that the stock option concept does not seem to fit.¹

First, stock options are not "amounts," i.e., money. They are contractual rights to buy shares. The employee is free to exercise the options or not as he or she sees fit.

Although the amount of money for which the stock can be purchased may be "fixed" in the sense that each option has a stated exercise price, that cannot be a criterion for determining whether stock options are wages because the option price is money the employee must pay, not the employer. The value to the employee is the amount for which the stock acquired through the option can be sold, and that "amount" varies unpredictably depending on market conditions, so it is not "fixed or ascertainable" by any method of calculation when the options are awarded. Moreover, the amount is not fixed or ascertained by any "standard" related to the quantity or units of work performed, which are usually the criteria by which wages are determined. Nor can stock options be analogized to pension plans or profit sharing plans because the latter are ordinarily based on continued length of service and the earnings of the participating employee and are usually fixed in amount.

However, we are cognizant that there are important public policy overtones peculiar to the State of Columbia that will inform the Columbia court's decision on this question of first impression. For that reason, we decline to speculate on the outcome, and we shall certify the following question for determination by the Columbia Supreme Court:

¹ We note in passing that Columbia Labor Code § 407 makes it illegal for an employer to condition on an employee's acquisition of stock or an interest in the business. If stock options were considered to be "wages," it would be difficult to reconcile such a characterization with the proscription of § 407, i.e., would having to pay his or her own money for the acquisition of the shares be tantamount to requiring an employee to pay for part of his or her "wages?" Given that stock options plans are an increasingly common form of employee incentive plan, such an interpretation would run counter to a trend that is generally acknowledged as a significant benefit to workers.

Are stock options awarded employees by their corporate employers and the proceeds therefrom "wages" within the meaning of Columbia Labor Code § 200?

If the Columbia Supreme Court answers the question in the affirmative, we will at that time turn to the question whether it would offend Columbia's public policy to apply Olympia law.

C. Columbia Civil Code § 1600

It is also beyond dispute that § 1600, which voids any contract to the extent that "anyone is restrained from engaging in a lawful profession, trade, or business," expresses a strong and fundamental public policy of the State of Columbia. The courts of Columbia strictly enforce the spirit and letter of that statute. See *McGill v. Donald Reuben Corp*. The statutory and case law in Olympia is to the contrary. Olympia follows the majority view that allows and enforces reasonable and limited restraints in the nature of covenants not to compete.

However, it is not necessary for us to decide whether the forfeiture provision that Dr. Ball objects to runs afoul of § 1600 and, if so, whether it would offend Columbia's public policy to apply Olympia law. That is because the forfeiture provision is *not* one that restrains Dr. Ball from working for a competitor. He was entirely free to do so. It is undisputed that he agreed that, if he did so within six months of exercising his options, he would give back any money he got from the stock options. Moreover, Dr. Ball could have exercised the options six months before he quit, kept the money, and *then* gone to work for the competitor. Or he could have continued to work unrestrained in his profession, gone to work for a non-competitor, and kept the money. Thus, it was no restraint at all. It was simply a contractual obligation to give back the money if he did what he had agreed not to do.

Thus, § 1600 is simply inapplicable here. Therefore, as to Dr. Ball's claim of violation of § 1600, we hold that Olympia law will be applied because there is no public policy to be vindicated by applying Columbia law. Of course, if the Columbia Supreme Court rules that stock options are wages, we will then have to revisit the choice of law issue to determine whether applying Olympia law would offend Columbia's public policy as expressed in § 221.

Accordingly, the judgment is reversed in part, and further proceedings in this matter are stayed pending the return of the question certified to the Columbia Supreme Court.